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No. 78481-7

SUPREME COURT
OF THE STATE OF WASHINGTON

CLERK

PETER H. ARKISON, CHAPTER 7 TRUSTEE FOR MICHELLE
CARTER,

Appellant,

v.

ETHAN ALLEN, INC.; RENKINS TRADING, INC., a/k/a/ RENKINS,
INC.; ETHAN ALLEN INTERIORS; and
JOHN DOE CORPORATIONS 1-5,

Respondents.

***ANSWER TO STATEMENT OF GROUNDS FOR DIRECT REVIEW
RAP 4.2(d)***

ON APPEAL FROM THE SUPERIOR COURT OF THE
STATE OF WASHINGTON FOR KING COUNTY
Cause No. 05-2-19740-4SEA

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TABLE OF CONTENTS

SYNOPSIS.....	1
1. Direct Supreme Court review is inappropriate because this appeal involves the trial court’s exercise of discretion based on case-specific facts and does not present a fundamental legal issue of broad public import.	2
a. Michelle Carter undeniably “played fast and loose with the courts,” and the trial court properly barred pursuit of her personal injury claim, whether in her own name or with the Trustee acting as the nominal “real party in interest.”	4
b. The trial court properly exercised its discretion to prevent Ms. Carter from reaping a benefit from her misconduct and to protect the integrity of the judicial system.....	5
2. If, as the Trustee argues, this case is distinguishable from <u>Cunningham v. Reliable</u> , and therefore calls for a different result, the Trustee should present that argument to Division I.	7
3. There are no “inconsistencies in the state appellate law” that call for direct Supreme Court review.	8
4. The trial court’s application of judicial estoppel, consistent with <u>Johnson</u> , <u>Cunningham</u> and <u>Garrett</u> , reflects sound judicial policy that places debtors, creditors and Trustees on notice that full disclosure is required.....	13
5. Conclusion.....	15

TABLE OF AUTHORITIES

CASES

<i>American States Insurance Company v. Symes of Silverdale, Inc.</i> 1500 Wn.2d 462, 78 P.3d 1266 (2003)	1, 11
<i>An-Tze Cheng v. K&S Diversified Investments</i> 308 B.R. 448 (9 th Cir. BAP 2004)	2, 9, 11, 12
<i>Biesek v. Soo Line R.R. Co.</i> 440 F.3d 410 (7 th Cir. 2006)	12, 13
<i>In Re Bilstat, Inc.</i> 314 B.R. 603 (Bkrtcy. S.D. Tex. 2004)	11
<i>Billmeyer v. Plaza Bank of Commerce</i> 42 Cal.App.4 th 1086, 50 Cal.Rptr.2d 119 (Cal App. 1995).....	10
<i>In re Coastal Plains, Inc.</i> 179 F.3d 197, 208 (5 th Cir. 1999), <i>cert denied</i> , 120 S.Ct. 936 (2000)	14
<i>Cunningham v. Reliable Concrete Plumbing, Inc.</i> 126 Wn. App. 222, 108 P.3d 147 (2005)..	1, 7, 8, 10, 11, 13, 14
<i>In Re Dewberry</i> 266 B.R. 916 (Bkrtcy. S.D.Ga. 2001)	11
<i>Falkner v. Forshaug</i> 108 Wn. App. 113, 29 P.3d 771 (2001)	2
<i>In Re Fineberg</i> 202 B.R. 206 (Bkrtcy. E.D.Pa. 1996)	11
<i>Garrett v. Morgan</i> 127 Wash.App. 375, 112 P.3d 531 (2005).....	1, 10, 11, 13, 14

<i>Johnson v. Si-Cor, Inc.</i> 107 Wn. App. 902, 28 P.3d 832 (2001)	2, 9, 11, 13, 14
<i>Markley v. Markley</i> 31 Wn.2d 605, 198 P.2d 486 (1948).....	1, 8
<i>New Hampshire v. Maine</i> 532 U.S. 742, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001) ...	2, 3, 9
<i>Parker v. Wendy's International, Inc.</i> 365 F.3d 1268 (11 th Cir. 2004)	11, 12
<i>Seattle-First Nat'l Bank v. Marshall</i> 31 Wn. App. 339, 641 P.2d 1194, <i>review denied</i> , 97 Wn.2d 1023 (1982).....	2

Rules

RAP 4.1	15
RAP 4.2(a)(3)	1, 15
RAP 4.2(a)(4)	1, 3, 15

Statutes

11 U.S.C. §522	7
11 U.S.C. § 522(d)(11)(D)-(E).....	13
11 U.S.C. § 726(a)(6)	7

Miscellaneous

19 Am. Jur., Estoppel, §§ 72-73	8
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SYNOPSIS

Direct Supreme Court review should be denied for four reasons:

(1) The trial court's application of judicial estoppel involved the proper exercise of discretion, based on case specific facts, and does not present a legal issue, much less a "fundamental and urgent issue of broad public import which requires prompt determination" in the Supreme Court under RAP 4.2(a)(4).

(2) If this case is distinguishable from *Cunningham v. Reliable*, as the Trustee argues, direct review is simply premature. The Trustee can and should make that argument in Division I.

(3) There are no "inconsistencies in state appellate law" that require direct review under RAP 4.2(a)(3). Judicial estoppel is a flexible, equitable doctrine, not a rigid set of rules – and *Markley v. Markley* did not hold otherwise. Nor did *American States v. Symes of Silverdale* hold that judicial estoppel cannot be applied, when the facts justify it, to bar a Trustee from pursuing a personal injury claim on behalf of a bankruptcy debtor who failed to disclose her claim prior to obtaining a "no asset" discharge of her debts. Finally, both *Cunningham v. Reliable* and *Garrett v. Morgan* properly barred post-discharge personal injury claims, whether asserted in the name of the debtor/plaintiff or the Trustee, when the facts indicated the debtor, not creditors, would likely reap the greatest benefit from pursuit of those claims.

(4) While the Trustee speculates that "this scenario bears a very substantial risk of repetition," there is no evidence that a significant number of bankruptcy cases involve debtors like Ms. Carter, who fail to disclose substantial known personal injury claims, obtain a "no asset" discharge, and then bring a personal injury lawsuit. In fact, it is very likely that after *Cunningham* and *Garrett*, counsel for debtors, creditors and Trustees will vigilantly ensure that there is full disclosure of personal injury claims on every debtor's sworn bankruptcy schedule. That is simply what the law requires – and it is precisely the result the doctrine of judicial estoppel is intended to accomplish.

1. Direct Supreme Court review is inappropriate because this appeal involves the trial court's exercise of discretion based on case-specific facts and does not present a fundamental legal issue of broad public import.

Judicial estoppel applies to bar a party from asserting a claim or position in a legal proceeding that is inconsistent with the claim or position taken by that party in a prior proceeding. "Judicial estoppel is a flexible equitable doctrine," not a strict and inflexible set of rules. *An-Tze Cheng v. K&S Diversified Investments*, 308 B.R. 448, 452 (9th Cir. BAP 2004). Trial courts exercise broad discretion to apply the doctrine to the specific facts in each case to protect the integrity of the courts, not to protect the interests of parties to litigation.

The purposes of the doctrine are to preserve respect for judicial proceedings without the necessity of resort to the perjury statutes; to bar as evidence statements by a party which would be contrary to sworn testimony the party has given in prior judicial proceedings; and to avoid inconsistency, duplicity and the waste of time.

Johnson v. Si-Cor, Inc., 107 Wn. App. 902, 906, 28 P.3d 832 (2001) (quoting *Seattle-First Nat'l Bank v. Marshall*, 31 Wn. App. 339, 343, 641 P.2d 1194, review denied, 97 Wn.2d 1023 (1982)). Thus, the trial court's application of judicial estoppel is reviewable only for an abuse of discretion. *Falkner v. Forshaug*, 108 Wn. App. 113, 124, 29 P.3d 771 (2001), citing *New Hampshire v. Maine*, 532 U.S. 742, 121 S.Ct. 1808, 149 L.Ed.2d 968 (2001).

The United States Supreme Court recently stated the basic purpose of judicial estoppel without mincing any words:

[T]o protect the integrity of the judicial process and to prevent parties from playing fast and loose with the courts by prohibiting parties from deliberately changing positions according to the exigencies of the moment.

New Hampshire v. Maine, 532 U.S. at 749-50.

This appeal does not present a "fundamental issue of broad public import" under RAP 4.2(a)(4). Instead, it merely seeks to overturn the trial court's exercise of discretion in applying judicial estoppel to the unique facts in this record. Those facts demonstrate Michelle Carter did indeed "play fast and loose with the courts." She knew she had a valuable personal injury claim, did not disclose it in bankruptcy, and obtained a full discharge of her debts. Years later, she was caught in the act, pursuing that claim exclusively for her own benefit. Nothing in the record showed that the belated reopening of her bankruptcy, and the Trustee's belated substitution as the nominal "real party in interest" in her personal injury lawsuit, would prevent Ms. Carter from reaping enormous benefit from her misconduct. There was no evidence that Ms. Carter's creditors, who had been forced to write off her debts three years before, would return to recover their claims in a reopened bankruptcy proceeding.

The Trustee asked the trial court, and now asks the appellate courts, to adopt a single, inflexible rule: judicial estoppel can never be applied to bar a bankruptcy Trustee from pursuing a debtor's personal injury claim in a Washington State court, period. The trial court instead looked at the facts, and applied straightforward equitable principles, to bar Ms. Carter or the Trustee from pursuing her claim, because the Trustee failed to show that Ms. Carter

would otherwise be prevented from using our state courts to reap a benefit from her misconduct. This does not present an issue of broad public interest that calls for direct Supreme Court review.

a. Michelle Carter undeniably "played fast and loose with the courts," and the trial court properly barred pursuit of her personal injury claim, whether in her own name or with the Trustee acting as the nominal "real party in interest."

Michelle Carter is no stranger to the legal system, having worked as a paralegal while enrolled in a paralegal training program. In the decade between 1988 and 1998, Ms. Carter asserted and obtained settlements for four personal injury claims – in 1988, 1990, 1996 and 1998. (A 036-039).

By August 2002, Michelle Carter apparently had accumulated over \$200,000 in consumer debt she allegedly could not pay. She filed a Chapter 7 bankruptcy petition, which stopped her creditors from seeking repayment. At the very same time, Ms. Carter was actively pursuing recovery for a personal injury claim against Ethan Allen, Inc., arising out of an incident that occurred just two weeks before her bankruptcy filing. Ms. Carter did not tell the Bankruptcy Court about her personal injury claim, although she had hired a lawyer to actively pursue it. As a direct result of her nondisclosure, Ms. Carter's bankruptcy was concluded as a "no asset" case. Thanks to the Bankruptcy Court, Ms. Carter obtained a "fresh start" and her debts were fully discharged. (A 019-035; 040-064).

Nearly three years later, in June 2005, Ms. Carter filed this personal injury lawsuit against Ethan Allen, claiming she was entitled to recover

\$1 million in damages. (A 014-018). By that time, she had enjoyed three years of freedom from debt. When Ethan Allen discovered the subterfuge, it asserted judicial estoppel as a defense in answer to Ms. Carter's complaint.

Caught with her hand in the cookie jar, Ms. Carter returned to the Bankruptcy Court and sought to reopen her bankruptcy – obviously believing this would preserve her claim. When Ethan Allen moved for summary judgment, asking the trial court to dismiss Ms. Carter's personal injury claim on judicial estoppel grounds, the Trustee moved to be substituted as the nominal plaintiff in the case. (A 001-006). Once named as plaintiff, the Trustee argued that judicial estoppel cannot apply, as a matter of law, because as a representative of Ms. Carter's creditors, he "cannot be tarred with the same brush" as Ms. Carter.

b. The trial court properly exercised its discretion to prevent Ms. Carter from reaping a benefit from her misconduct and to protect the integrity of the judicial system.

The trial court was faced with a dilemma. On one hand, barring Ms. Carter or the Trustee from pursuing her claim could deprive Ms. Carter's creditors of a possible source of recovery on the debts that were discharged in 2002. On the other hand, the Trustee provided no evidence that any of Ms. Carter's creditors had actually reappeared to assert the claims they had been forced to abandon, and probably wrote off their balance sheets, three years earlier. Furthermore, even if the creditors did return to stake their claims, Ms.

Carter claimed damages far in excess of her debts.¹ The Trustee offered no assurance that Ms. Carter would not ultimately reap an enormous benefit from her personal injury claim, leaving her no worse off for having hidden her personal injury claim from the Bankruptcy Court for three years.²

In short, the record showed that if judicial estoppel were not applied to bar the claim, Ms. Carter might be handsomely rewarded, despite her undeniable subterfuge. Furthermore, the Trustee's efforts to "replay" the Carter bankruptcy a second time merely demonstrated that by failing to disclose her known personal injury claim three years earlier, Ms. Carter had substantially undermined the integrity and orderly functioning of the Bankruptcy Court.

On this record, the trial court did not abuse its discretion by barring Ms. Carter's personal injury claim, whether pursued in her own name or in the name of the Trustee. Because judicial estoppel is a "flexible equitable doctrine," this case -- and every other case involving judicial estoppel -- hinges on the facts. On appeal, the Trustee has failed to present an "urgent issue of broad public import which requires prompt and ultimate determination." The only issue here is whether Ms. Carter should be permitted to recover nearly \$1 million for a

¹ In fact, one of Ms. Carter's attorneys submitted a declaration which asserted that her "dischargeable debts" were only \$40,000. If this were true, even if all of her creditors had reappeared in 2005 to claim what was owed -- not extremely likely -- Ms. Carter stood to retain virtually all of the value of her alleged \$1 million personal injury claim. Viewed in this light, substitution of the Trustee for Ms. Carter was a virtually meaningless gesture that still left Ms. Carter in the same position she would have been in had she truthfully disclosed her claim in 2002. (A 007-010).

personal injury claim she hid from her creditors in order to obtain a "no asset" discharge three years earlier, merely because the Trustee has been substituted as the nominal plaintiff in her personal injury action. The trial court properly answered "no" to that question.

2. If, as the Trustee argues, this case is distinguishable from Cunningham v. Reliable, and therefore calls for a different result, the Trustee should present that argument to Division I.

In *Cunningham v. Reliable Concrete Plumbing, Inc.*, 126 Wn. App. 222, 108 P.3d 147 (2005), Cunningham suffered a workplace injury. He subsequently filed a Chapter 7 bankruptcy. Cunningham did not disclose his personal injury claim against a third party defendant. After he received a "no asset" discharge of his debts, Cunningham filed a personal injury lawsuit seeking recovery far in excess of his creditors' claims. When the defendant asserted judicial estoppel as a defense, the plaintiff advised the Trustee and reopened his bankruptcy. When the defendant moved for summary judgment, the plaintiff argued that his bankruptcy had been reopened and that by dismissing his claims, the court would merely penalize his creditors. The trial court dismissed the plaintiff's claims. On appeal, Division I affirmed.

On its face, *Cunningham* is on all fours with this appeal. However, the Trustee argues that *Cunningham* is distinguishable, because the nominal plaintiff/appellant in that case was the debtor, not the Trustee; and thus,

² In fact, the Trustee told the trial court that Ms. Carter would have an exemption claim under 11 USC § 522 and a right to all proceeds not claimed by creditors under 11 USC § 726(a)(6). (A 005).

Cunningham does not apply to bar a Trustee from pursuing a personal injury claim not disclosed in a prior bankruptcy. If that is true – and if Division I did not intend to extend *Cunningham* to bar a Trustee in bankruptcy from pursuing a personal injury claim under the circumstances presented here, Division I can say so in response to this appeal.³

3. *There are no "inconsistencies in state appellate law" that call for direct Supreme Court review.*

Markley v. Markley, 31 Wn.2d 605, 198 P.2d 486 (1948) did not establish six essential and inflexible elements for judicial estoppel, as the Trustee argues. A careful reading of *Markley* reveals that the Court did no more than quote, in *dicta*, a discussion of "equitable estoppel" contained in 19 Am. Jur., Estoppel, §§ 72-73. The quoted material described six factors that "have been enumerated as essentials to the establishment of an estoppel." However, the same quoted material also stated that "courts are not altogether agreed, however, as to the application of some of these limitations," and continued at considerable length to describe cases in which "equitable estoppel" was applied even though many of these six "essentials" were absent. *Markley*, 31 Wn.2d at 614-615. The Trustee's argument that direct review is required because "the three divisions of the Court of Appeals have not followed *Markley*" attempts to

³ The Trustee attempts to rely on a distinction without a difference. Although the reported decision in *Cunningham* identifies the debtor/plaintiff as the *pro se* appellant, only the *Cunningham* Trustee briefed and argued the appeal. The Trustee retained counsel, who appeared on behalf of the Trustee and urged Division I to reverse because the debtor/plaintiff's personal injury claim belonged to the bankruptcy estate and would be pursued for the benefit of creditors. (A 078-096).

elevate *dicta* drawn from an outdated "Am. Jur." note into an inflexible rule of law – while ignoring the many exceptions to the "rule" included in that *dicta*.

At the same time, the Trustee points to the Ninth Circuit Bankruptcy Appellate Panel's decision in *An-Tze Cheng*, 308 B.R. 448 (9th Cir. BAP 2004) as a proper statement of the law that Washington courts should follow. However, *An-Tze Chang* describes judicial estoppel as a "flexible equitable doctrine that encompasses a variety of abuses" and that may be "invoked by a court at its discretion." The decision notes that the United States Supreme Court's *New Hampshire v. Maine* decision cautioned against imposing "inflexible prerequisites" on the application of judicial estoppel, because of the "dynamic nature" of the judicial estoppel remedy. *An-Tze Chang*, 308 B.R. at 453, 459. The fact that the three divisions of our Court of Appeals have not imposed identical "inflexible prerequisites" to judicial estoppel in every reported case merely follows the lead of the United States Supreme Court in *New Hampshire v. Maine* and of the Bankruptcy Appellate Panel in *An-Tze Chang*.

Using judicial estoppel as a "flexible equitable doctrine," Washington's three appellate divisions have examined each case to determine whether the trial court properly exercised its discretion to prevent a litigant from "playing fast and loose with the courts." In *Johnson v. Si-Cor, Inc.*, 107 Wn. App. 902, 28 P.2d 832 (2001), Division Three considered whether a debtor's nondisclosure of a post-petition claim would bar pursuit of that claim after the debtor had been discharged. The Court concluded that the claim would not have been available

to creditors in the bankruptcy in any event; that the nondisclosure had not affected the outcome of the bankruptcy or benefited the debtor; and thus the debtor's subsequent lawsuit would not be barred by judicial estoppel.

However, in *Cunningham and Garrett v. Morgan*, 127 Wash.App. 375, 112 P.3d 531 (2005), Divisions I and II utilized judicial estoppel to bar pursuit of pre-petition personal injury claims that debtors had an affirmative duty to disclose, but did not disclose prior to obtaining a full "no asset" discharge of their debts. In both cases, the fact that the Trustee had reopened the bankruptcy proceedings *after* a defendant had asserted judicial estoppel as a defense made no difference, and rightfully so. The time and expense of administering the same bankruptcy a second time is, by itself, sufficient reason to invoke judicial estoppel to preserve the integrity of the judicial process. *See Billmeyer v. Plaza Bank of Commerce*, 42 Cal.App.4th 1086, 1092, 50 Cal.Rptr.2d 119 (Cal. App. 1995) (Trustee's authorization to pursue a claim not properly disclosed in bankruptcy "is of no moment" to a state court when considering whether judicial estoppel bars the claim). Furthermore, unless a Trustee can assure the Washington trial court that the claim will benefit only creditors -- and that the debtor will be barred from obtaining any proceeds from her undisclosed claim -- the fact that the Trustee is the nominal personal injury plaintiff should make no difference. Our courts should not be required to aid a debtor who fails to honestly disclose a valuable claim to her creditors, obtains the benefits of the

automatic stay in bankruptcy and a discharge of her debts, and later attempts to pursue the claim for her own account.

American States Insurance Company v. Symes of Silverdale, Inc. 150 Wn.2d 462, 78 P.3d 1266 (2003) is not "inconsistent" with the application of judicial estoppel in *Johnson, Cunningham, Garrett* or this case. In *Symes*, the question was whether an insurer could assert a contract defense against a bankruptcy Trustee based on the insured's post-petition conduct. However, judicial estoppel is an equitable doctrine, not a matter of contract or of federal bankruptcy law. The substitution of a Trustee in place of the debtor/plaintiff cannot automatically bar a Washington State court from utilizing the judicial estoppel remedy. Application of judicial estoppel in Washington courts is a question of Washington law, not federal bankruptcy law.⁴ In any event, many federal Bankruptcy Courts hold that both the debtor and the Trustee may be barred from pursuing claims based on the debtor's misconduct. *See, e.g., In re Bilstat, Inc.*, 314 B.R. 603 (Bkrtcy. S.D.Tex. 2004) (Trustee barred from avoiding preferential transfer); *In re Fineberg*, 202 B.R. 206 (Bkrtcy. E.D.Pa. 1996) (Trustee barred from pursuing claims previously dismissed by debtor).

⁴ For example, in *In re Dewberry*, 266 B.R. 916, 920 (Bkrtcy. S.D.Ga. 2001), the Bankruptcy Court held that when a debtor seeks to assert a claim that he wrongfully failed to disclose in bankruptcy, the Court hearing the undisclosed claim has "exclusive jurisdiction" to decide whether the debtor's conduct was "so tainted as to warrant imposition of the rule [judicial estoppel] in the case pending there."

Furthermore, neither *An-Tze Cheng* nor *Parker v. Wendy's International, Inc.*, 365 F.3d 1268 (11th Cir. 2004) would condone the result the Trustee seeks in this case. *An-Tze Cheng* cautioned that judicial estoppel should not be applied against a Trustee if doing so would impose substantial penalties on innocent creditors, but also noted that the application of judicial estoppel against a Trustee should be based on a case by case evaluation of the facts.⁵ Here, the record indicated that virtually all of the damages sought, no matter whose name appeared as "plaintiff" in the caption, would benefit Ms. Carter, not her creditors – assuming that any creditors bothered to reassert their claims at all, three years after the Carter bankruptcy was closed. Similarly, while *Parker* held that a Trustee could not be estopped from pursuing a personal injury claim for the benefit of creditors, the *Parker* panel also observed that the non-disclosing debtor should be barred from any recovery for her undisclosed claim. *Parker*, 365 F.3d at 1273, n.4 (judicial estoppel should be invoked to limit recovery to the amount due creditors to "prevent an undeserved windfall from devolving to a non-disclosing debtor").

The Trustee also points to *Biesek v. Soo Line R.R. Co.*, 440 F.3d 410 (7th Cir. 2006), but *Biesek* expressly declined to decide whether a Trustee "could intervene and take over" a personal injury lawsuit that a nondisclosing debtor was barred from pursuing on his own behalf. However, *Biesek* did accurately

⁵ *An-Tze Chang* addressed a very different situation, in which judicial estoppel was invoked to favor one creditor over another. Those facts bear no resemblance to our own case.

observe that "plenty of authority" supports the proposition that a debtor may not receive a discharge in bankruptcy by representing he has no valuable assets and later "turn around after the bankruptcy ends and recover on a supposedly nonexistent claim." *Biesek*, 440 F.3d at 412.

Here, the trial court had no assurance that the Trustee's appearance as a nominal plaintiff would bar Ms. Carter from obtaining a personal recovery for the personal injury claim that was "supposedly nonexistent" when she obtained a "no asset" discharge. Given the likelihood her creditors were long gone and would recover little or nothing, the trial court had good reason to apply judicial estoppel to bar the Trustee from pursuing the claim as a nominal plaintiff, knowing that otherwise the claim was most likely to inure primarily to Ms. Carter's own benefit, not her creditors.

4. The trial court's application of judicial estoppel, consistent with Johnson, Cunningham and Garrett, reflects sound judicial policy that places debtors, creditors and Trustees on notice that full disclosure is required.

According to the Trustee, sound judicial policy would permit a bankruptcy debtor to hide a personal injury claim from the Bankruptcy Court, obtain a "no asset" discharge, and pursue the claim years later, hoping no one would uncover the deception. When caught, the debtor may merely reopen her Bankruptcy, ask the Trustee to substitute as the nominal plaintiff, and proceed as if nothing had ever occurred. Even if all creditors come to the table despite the delay, the plaintiff is no worse off for having lied to the Bankruptcy Court. The debtor may remain entitled to an exemption for a portion of the tort recovery

under 11 USC § 522(d)(11)(D)-(E). Amounts recovered in excess of creditors' claims would still go to the non-disclosing debtor. According to the Trustee, Washington courts should be powerless to do anything to prevent this result.

Federal Courts have repeatedly condemned the Trustee's approach, which would permit nondisclosing debtors to pursue their hidden claims with impunity. *See, e.g., In re Coastal Plains, Inc.*, 179 F.3d 197, 208 (5th Cir. 1999), *cert denied*, 120 S.Ct. 936 (2000). *Johnson, Cunningham and Garrett* also condemn that approach – for obvious reasons. Sound judicial and public policy requires a flexible equitable remedy that will punish and deter "playing fast and loose with the courts." We already have that remedy – judicial estoppel.

While the Trustee speculates that "this scenario bears a very substantial risk of repetition," the Trustee offers no hard facts to support that speculation. Indeed, after the *Johnson, Cunningham and Garrett* trilogy, debtors, creditors, Trustees and their counsel are undoubtedly on red alert and will ensure that personal injury and other contingent claims are fully disclosed in sworn bankruptcy schedules. The risk that a debtor, and possibly her creditors, will forfeit the right to pursue undisclosed claims will force all involved in the bankruptcy process to be vigilant to ensure full disclosure – which is no more and no less than the Bankruptcy Code requires in the first instance. If the risk of losing an undisclosed claim were eliminated entirely – as the Trustee suggests – "this scenario" surely will become more common.

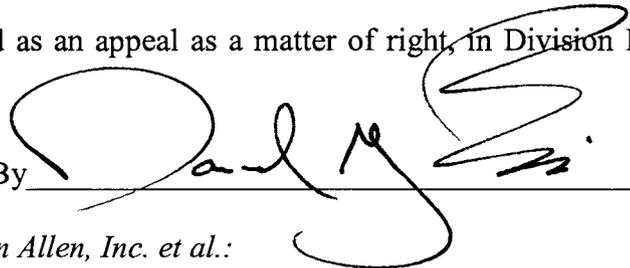
The Trustee states that nearly 40,000 Chapter 7 cases were filed in Washington in 2005. How many of those cases involved debtors who knew they had valuable personal injury claims, hid those claims from their creditors and the Bankruptcy Court, lay in the weeds for years, and attempted to pursue those claims for their exclusive benefit until caught by their adversary? The Trustee's silence indicates the number must be small. The number will no doubt be even smaller now that debtors, creditors, Trustees and their counsel know that in Washington State courts, the judicial estoppel remedy has teeth.

5. Conclusion

The bankruptcy Trustee urged the trial court to adopt an inflexible rule that would bar a trial court from applying the judicial estoppel remedy whenever a Trustee has become the nominal plaintiff in a personal injury lawsuit. However, there is no judicial or public policy in favor of protecting debtors who decline to disclose valuable tort claims in bankruptcy proceedings. When the record shows that the non-disclosing debtor could be handsomely rewarded for a claim she hid from the Bankruptcy Court prior to obtaining a discharge of her debts, a trial court should have discretion to apply judicial estoppel to bar such recovery, no matter who the nominal plaintiff might be.

Direct Supreme Court review is not appropriate under RAP 4.2(a)(3)-(4). This matter should be decided as an appeal as a matter of right, in Division I, under RAP 4.1.

By



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